FT PYMES SANTANDER 14

SME ABS

Ratings

Series	Rating	Notional (EUR m)	Notional (% assets)	CE (% assets)	Coupon	Final maturity
Serie A	AA+SF	1,941.5	88.3	16.75	Euribor 3M +0.30%	Nov 2057
Serie B	BB+SF	258.5	11.8	5.0	Euribor 3M +0.50%	Nov 2057
Serie C	CCCSF	110.0	5.0	0.0	Euribor 3M +0.65%	Nov 2057
Rated notes	2,310.0					

Our quantitative analysis is based on the preliminary portfolio dated 15 October 2018, provided by the management company. Our Structured Finance Ratings constitute an opinion about relative credit risks and reflect the expected loss associated with the payments contractually promised by an instrument on a particular payment date or by its legal maturity. See our website for the SF Rating Definitions.

Transaction details

Purpose	Liquidity/Funding
Issuer	FT PYMES Santander 14
Originator/Servicer Account bank/paying agent	Banco Santander S.A. (AA-/S-1/Stable)
Closing date	26 November 2018
Legal final maturity	1 November 2057
Payment frequency	Quarterly

The transaction is a true-sale securitisation of a EUR 2.2bn portfolio of unsecured loans (63.5%), credit lines (29.9%) and secured loans (6.6%) granted to small- and medium-sized enterprises (SMEs) and individuals in Spain to finance diverse business needs. The assets were originated by Santander, as well as Banesto and Banif, two banking franchises fully integrated into Santander.

Rating rationale (summary)

The final ratings reflect the quality of the underlying collateral in the context of the Spanish macroeconomic environment; the legal and financial structure of the transaction; the transaction-specific protection features; the counterparty risk exposure to Santander; and the management ability of Santander de Titulización SGFT SA. The ratings factor in the notes' protection against portfolio losses, provided by their respective credit enhancement and periodic gross excess spread, which stands at 1.3% as of the pool cut-off date.

The serie A rating reflects the tranche's short expected weighted average life of 0.9 years and 16.75% of credit enhancement protection against losses, which includes a 5.0% reserve fund. This level of credit enhancement, while lower than that of previous PYMES Santander transactions, is coupled with higher-quality obligors in the portfolio.

The serie B rating reflects a longer expected weighted average life of 4.4 years and 5% credit enhancement provided by the reserve fund. The tranche is also exposed to medium-term economic uncertainties in Spain beyond our outlook.

The serie C provides funds for the cash reserve, and its rating reflects the expected provisioning of portfolio losses from this reserve.

Counterparty risk exposure is well mitigated by i) the automatic guarantee or replacement of the bank upon loss of a long-term BBB rating by Scope (as account bank, paying agent and liquidity facility provider); ii) our view on Santander's long-term credit quality (AA-/S-

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Related Research

SME ABS Rating Methodology, August 2018

Methodology for Counterparty Risk in Structured Finance, August 2018

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1/Stable); and iii) the expected short life of the serie A. The bank's systemic importance and resolvability also supports this view.

Rating drivers and mitigants

Positive rating drivers

Experienced originator. The transaction benefits from the assets' proven performance and the experience of the originator. This is the 14th securitisation of the PYMES series issued by Santander and we calibrated its performance assumptions considering analysis of comparable transactions in the series. Santander follows prudent underwriting standards consistent with those of the previous securitisations.

Obligor credit quality. The portfolio's obligors are on average stronger than those in previous PYMES transactions we have rated, based on Santander's internal credit measures. Santander's weighted average one-year probability of default for the portfolio is 0.9%, significantly lower than the 2.1% in PYMES 13.

Fast amortisation. The serie A's short expected life, mainly driven by the fast amortisation of the credit line segment, substantially limits the risk exposure to asset deterioration and to Santander as transaction counterparty, as well as possible macroeconomic deterioration.

Negative rating drivers

Unsecured exposures. 93.4% of the portfolio consists of unsecured exposures, i.e. loans and credit lines. This is higher than previous PYMES transactions that we have analysed and introduces the potential for lower recovery rates when compared to secured positions.

Limited vintage data. Loan vintage data provided by Santander only captures performance from 2012 onwards, which does not capture a complete credit cycle nor reflects the most stressed economic periods in Spain. As a mitigant, we incorporated information reflected in vintage data available from PYMES 13 into the analysis to capture a broader performance period.

Relatively low credit enhancement. The credit enhancement available for the serie A is lower for this transaction compared to previous PYMES transactions that we have analysed, but reflects the obligors' higher credit quality.

Unhedged interest rate risks. 27.6% of the portfolio pays a fixed-rate coupon, while the notes will pay a floating-rate coupon referenced to three-month Euribor. The relatively short expected life of the serie A mitigates interest rate risk, while mezzanine and junior noteholders are more exposed due to the notes' longer expected life.

Upside rating-change drivers

Better-than-expected asset performance, as well as faster-than-expected portfolio amortisation if credit enhancement builds up before credit losses crystallise, may positively impact the ratings.

Downside rating-change drivers

Worse-than-expected asset performance as well as a deterioration of the Spanish macroeconomic environment could negatively impact the ratings.

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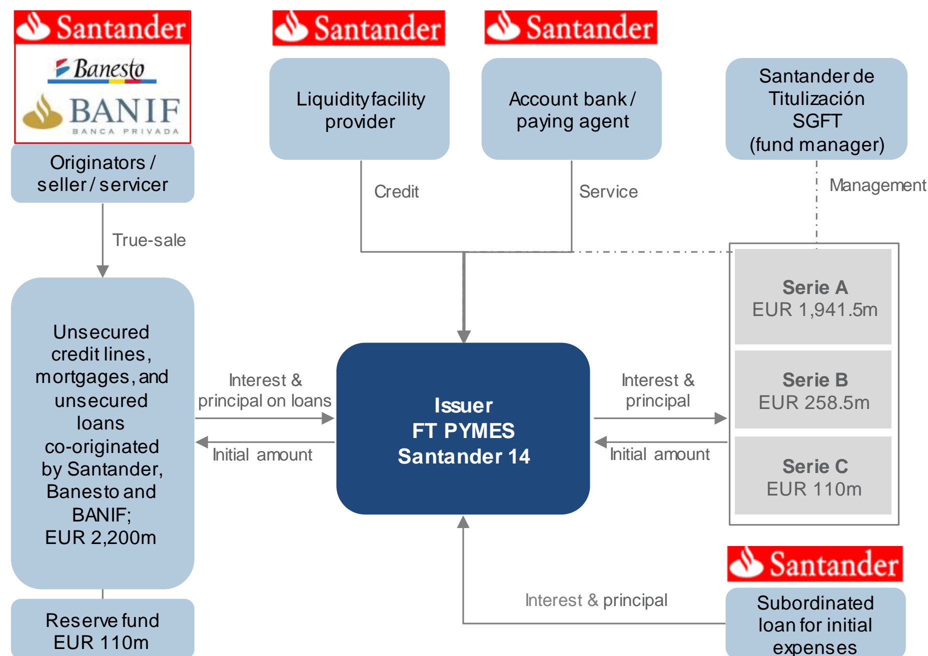
1. Transaction summary

Figure 1. Transaction diagram



Source: Transaction documents and Scope.

The securitised portfolio was originated in the ordinary course of business by Banco Santander SA, Banesto and Banif. It contains three main product types: unsecured loans (63.5% of the portfolio balance), credit lines (29.9%) that are mostly unsecured, and secured loans (6.6%). The credit lines have been drawn to approximately 97% of their collective limit but can be further drawn post-closing to up to 105% of their respective committed amount. Potential credit line draw-downs are funded by collections from the assets or a liquidity facility provided by Santander if collections are not sufficient.

The transaction features three tranches of sequentially amortising notes with a combined priority of payments, an amortising reserve fund, and the liquidity facility. Serie B interest ranks senior to serie A principal unless a 5% cumulative default trigger is breached. Interest and principal payments on serie C, which fund the reserve fund, are fully subordinated to the mezzanine and senior notes. The amortisation of the reserve fund has a floor at EUR 55m, which equates to 2.5% of the combined serie A and serie B initial balance.

Santander (AA-/S-1+/Stable) performs all counterparty roles in the transaction as the originator, servicer, issuer account bank, paying agent, and liquidity facility provider.

2. Asset analysis

2.1. Securitised portfolio

The portfolio of unsecured loans, credit lines and secured loans were granted to SMEs and self-employed individuals in Spain to finance core business needs. The portfolio is effectively split into six sub-segments based on product type and obligor size (see Figure 2). We calibrated our cash flow assumptions based on these sub-segments. There are no debt-consolidation products in the portfolio, unlike in legacy deals from Santander's PYMES series.

Figure 2. Asset segmentation as per the portfolio segmentation criteria

Product type	Large obligors* (% of portfolio)	Small obligors* (% of portfolio)
Unsecured loans	40.1	23.4
Credit lines	26.9	3.0
Mortgages	5.1	1.5

Figure 3. Industry distribution

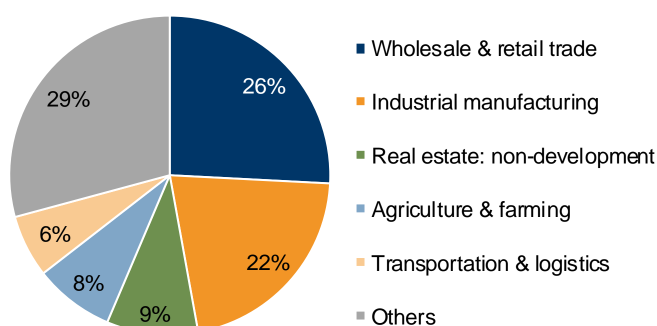
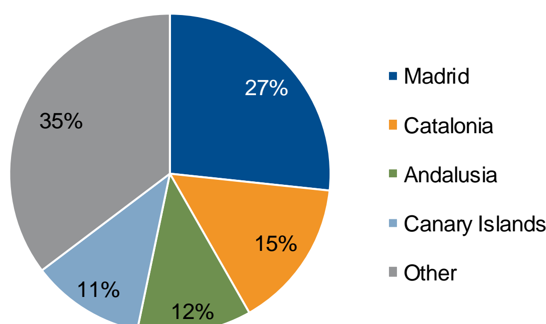


Figure 4. Geographic distribution



The portfolio is stronger than those in previous PYMES deals we have rated. At closing, Santander's weighted average one-year probability of default for the portfolio is 0.9% versus 2.1% at closing for PYMES 13. The transaction also benefits from positive selection as eligibility criteria excludes exposures that are more than 30 days delinquent as of closing.

The 15 October 2018 portfolio has a weighted average seasoning of 2.8 years, a remaining term to maturity of 3.0 years, and a weighted average life of 1.6 years. The assets were primarily originated after 2010 (95%), with a large share from 2017 (46%). 72% of the portfolio consists of floating-rate loans and the remainder are fixed. Only 6.6% of the portfolio is secured by mortgages, while the remainder we have treated as fully unsecured.

We do not consider sector concentration to be a significant credit risk. The three largest sectors – retail, industrial and real estate – account for about 56.4% of the portfolio. The remaining sectors are very well diversified.

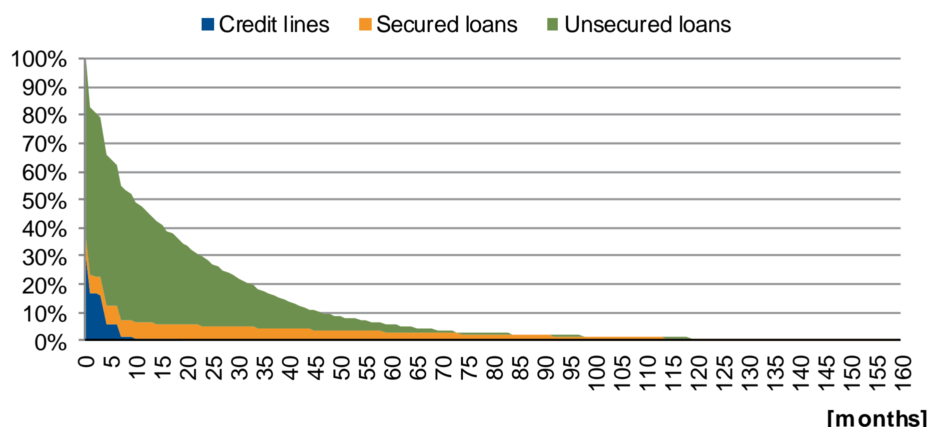
2.2. Fast amortisation

Serie A has a short risk exposure to counterparties and to macroeconomic deterioration, thanks to an expected weighted average life of 0.9 years under a 15% constant prepayment rate. The fast amortisation is driven by credit lines with a weighted average life of just over three months and by the mostly French amortisation schedule.

Three distinct amortisation phases during the transaction's life

The portfolio features three distinct periods for the transaction: i) an early stage in which the serie A amortises quickly due to fast-amortising credit lines; ii) a middle stage in which unsecured loans and mortgages are the main exposures; and iii) a late stage with a potentially lumpy outstanding portfolio primarily composed of mortgages. The build-up of credit enhancement, driven by the strictly sequential amortisation of the notes, may mitigate concentration risk towards the end of the transaction.

Figure 5. Portfolio amortisation under 15% constant prepayment rate and 0% default rate



2.3. Portfolio assumptions

Figure 6. Summary of portfolio assumptions per asset sub-segment

		Portfolio	Credit lines – Small obligors	Credit lines – Large obligors	Secured loans – Large obligors	Secured loans – Small obligors	Unsecured loans – Large obligors	Unsecured loans – Small obligors
Portfolio inputs	Share (%)	100%	26.9%	3.0%	5.1%	1.5%	40.1%	23.4%
	Recovery rate, B	55.85%	73.7%	51.8%	64.1%	68.0%	36.1%	31.3%
	Recovery rate, AAA	16.8%	15.6%	0.4%	36.4%	40.8%	4.9%	19.9%
	Recovery rate lag (months)	21	19	14	60	60	20	20
	Low constant prepayment rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	High constant prepayment rate	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%
	Fixed-rate assets	28%	21%	36%	10%	11%	27%	41%
	Floating-rate assets	72%	79%	64%	90%	89%	73%	59%
	Fixed – weighted average all-in coupon	2.4%	1.2%	4.1%	2.1%	2.5%	1.5%	5.2%
	Floating – Weighted average margin	2.0%	1.8%	3.3%	1.7%	1.6%	1.4%	3.0%
Point-in-time	Default rate	3.2%	5.4%	2.2%	5.0%	7.5%	1.5%	3.0%
	Coefficient of variation	65.9%	82.9%	127.9%	59.3%	50.6%	52.2%	42.9%
Long-term	Default rate	1.4%	2.3%	1.0%	2.3%	3.5%	0.7%	1.3%
	Coefficient of variation	148.6%	192.0%	290.7%	128.7%	109.8%	116.7%	96.7%

2.3.1. Unsecured loans

This segment has a seasoning of 2.0 years and a remaining term of 3.7 years. These loans are also well diversified: 32,248 obligors for 36,161 loans (top 10 obligors: 4.1%) with an average size of EUR 44,256.

Unsecured loans account for 63.5% of the portfolio, none of which are restructured loans.

Santander's underwriting standards for these loans are generally stricter, given the lack of security over mortgages. This results in better performance in default terms compared to its mortgages. For this transaction, 'unsecured' means 'not secured by a mortgage', although most of these unsecured loans benefit from personal guarantees or other types of security that are generally effective at reducing delinquencies or increasing recoveries.

71.5% of the segment features a French amortisation scheme with the remainder having a linear amortisation scheme.

2.3.2. Credit lines

This segment represents 29.9% of the asset pool and is characterised by a short expected weighted average remaining term of seven months and a usage rate of 97%.

For credit lines, there are two risks that are otherwise not present in static portfolios of amortising loans:

Credit lines introduce revolving risk and refinancing risk

1) Revolving risk: Under the legal documentation, committed and partially undrawn credit lines can be further drawn upon after the transaction closes. At risk of default is the credit line's full commitment, not its current balance, but only to the extent of amortisation.

2) Refinancing risk: The credit lines' current balance does not reflect a stress scenario in which weak obligors, before defaulting on their credit lines, use them to remain current on other debts. Defaulted obligors may draw on credit lines which cannot be cancelled before maturity. However, the short weighted average remaining term of the credit lines limits the impact on portfolio default.

We do not stress the credit line balances beyond their initial commitment. Under exceptional circumstances the contract's balance can increase quickly to up to 105% of the initial commitment. Overdrafts must be approved by Santander's risk department, and the obligor must prove it can quickly return the balance to normal.

The effective maturity of these contracts is usually less than a year. The credit lines will be removed from the portfolio at the earliest renewal date or on maturity, significantly mitigating revolving and refinancing risks.

We believe the refinancing risk of credit lines to be immaterial for the serie A. Exceptional refinancing risk is only possible if Santander cannot grant a new credit line to the obligor at maturity or refund the issuer at renewal.

Credit lines are likely to be funded with collections

The liquidity facility is unlikely to fund increases in credit line balances. Potential further drawdowns amount to EUR 58.8m and represent available headroom above the current 97% usage level. If usage increases, the expected amortisation of the portfolio can generally provide sufficient principal repayments to service any credit line drawings. The liquidity facility is set to represent 5% of the serie A notes.

2.3.3. Secured loans

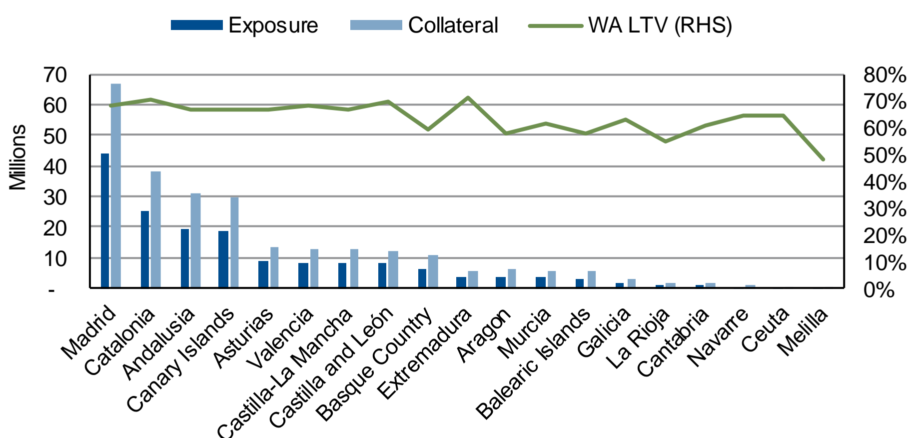
Secured loans only account for 6.6% of the portfolio.

This segment only accounts for 6.6% of the portfolio, significantly less than the 23.2% found in PYMES 13. The mortgage segment has a weighted average seasoning of 4.6 years and a weighted average remaining term to maturity of 11.3 years. The weighted average loan-to-value for these mortgages is 67.0% based on current appraisals.

The secured loan segment is not exposed to debt consolidation products, which tend to have very high default rates.

This segment carries concentration risk for the serie B as the tail of the transaction's life will be exposed to mortgages. In addition, the segment's long maturity exposes the serie B to potential economic deterioration in Spain beyond our current outlook. This risk is expected to be mitigated by credit enhancement build-up from the deleveraging of the transaction.

Figure 7. Mortgage exposures and collateral geographic distribution



2.4. Top obligors

The portfolio is granular and well diversified. The two largest obligor exposures represent 1.2% of the portfolio. Both obligors have above-average credit quality (compared to the securitised portfolio), based on Santander's probability of default figures. The top-10 obligors account for 4.8% of the total portfolio and have a 0.44 weighted average probability of default, lower than the portfolio average of 0.94.

3. Originator and seller

Santander's functions, systems, processes and staff meet the highest standards of European banking

Banco Santander is an experienced originator of SME ABS, with PYMES 14 being the eighth Spanish SME ABS that we have analysed and rated. Santander generally securitises all eligible assets in its loan book, except for mortgages eligible to back Spanish mortgage-covered bonds (cedulas hipotecarias) and assets excluded under Spanish securitisation law (i.e. real estate development loans or syndicated loans). Santander is a sophisticated bank whose functions, systems, processes and staff meet the highest standards of European banking.

Strong underwriting standards for the assets in this portfolio

Since 2009, Santander has applied relatively conservative underwriting standards. These standards are reflected in the portfolio, most of which has been originated since 2015.

Santander's interests are strongly aligned with those of noteholders. As a provider of the 5% reserve fund and holder of the entire capital structure at closing, Santander has a significant subordinate interest in the transaction. In addition, the Spanish securitisation framework does not allow securitised and non-securitised assets to be treated differently on the bank's balance sheet.

Santander's pre-delinquency monitoring and early-delinquency management are highly efficient. Additionally, their servicing and recovery processes aim to maximise prospects of recovery in the shortest possible time.

4. Portfolio assumptions

We undertook a bottom-up analysis and analysed the portfolio by sub-segment to capture all underlying features of the asset pool. The approach was derived from our analysis of vintage data representative of the securitised portfolio.

4.1. Mean default rate

We supplemented vintage data with information from previous PYMES transactions

We derived the portfolio base case assumptions for secured and unsecured loans using vintage loan data from 2012 onwards, which does not capture a complete credit cycle nor reflects the most stressed economic periods in Spain. Base case assumptions for the credit lines were derived from vintage credit line data from 2011 onwards. We further broadened our analysis of the performance period by considering information from PYMES 13 vintage data, which dates back to 2010.

The portfolio was analysed by sub-segment. Portfolio-consolidated figures are a point-in-time '90 days past due' mean default rate of 3.2% and a lifetime default rate of 1.4% (see Figure 6).

These default assumptions incorporate a 1.08x adjustment to the credit lines to account for undrawn amounts as well as the associated refinancing and revolving risks of this product.

4.2. Coefficient of variation

The portfolio's consolidated coefficients of variation are 65.9% and 148.6% for the point-in-time scenario and long-term scenario, respectively. These high levels of volatility are mainly driven by i) the high volatility observed in the vintage data; and ii) the additional stress we applied to the credit lines' coefficients of variation to capture potential volatility in this segment.

4.3. Recovery rate and recovery lags

We analysed the recovery vintage data provided by Santander for the six sub-asset segments in the portfolio. The base case recovery rate of 55.9% for the portfolio is very much in line with that of PYMES 13 (55.1%).

For the mortgage-backed portfolio segments, we have used our fundamental recovery analysis framework to derive base-case and stressed recovery assumptions (see Figure 8). We have assumed a recovery lag of 60 months for these portfolio segments.

Figure 8. Recovery rates: secured mortgage loans

	B	BB	BBB	A	AA	AAA
Secured loans – large obligors	64.1%	58.6%	53.0%	47.5%	42.0%	36.4%
Secured loans – small obligors	68.0%	62.6%	57.1%	51.7%	46.3%	40.8%

Our fundamental recovery framework estimates the current value of the security on a line-by-line basis, and then applies rating-conditional haircuts to the assumed collateral value. The recovery rates are based on i) the closing loan-to-value for term loans; and ii) the effective loan-to-value for withdrawals using credit lines.

We have estimated current security values in three steps. First, we applied a 30% haircut to appraisal values. This is because the typical valuations are either desktop types, which we consider to be lower quality than full valuations, or relatively outdated. We then updated the post-haircut appraisal value through indexation (from the appraisal date to the current date) using the Spanish Ministry of Development's regional house price

indices. Finally, we applied rating-conditional haircuts, reflecting our forward-looking view on the security liquidation values.

No cure rate was applied as cures were captured in the vintage data.

4.4. Constant prepayment rate (CPR)

We tested 0% and 15% CPR assumptions

We analysed all rated notes under a 15% CPR assumption, as the notes do not benefit from prepayments. A 0% CPR assumption was also considered. These assumptions capture the very volatile historical constant prepayment rates (8% to 20%) observed in previous PYMES transactions.

5. Financial structure

5.1. Capital structure

The transaction is a strictly sequential three-tranche cash-flow securitisation. The issuance proceeds from the serie A and B notes were used to purchase the initial portfolio of assets. Serie C proceeds were used to fully fund a cash reserve on the closing date.

The notes pay quarterly interest referenced to three-month Euribor plus a margin equal to 30bps, 50bps and 65bps for the serie A, serie B and serie C respectively. The amortisation is strictly sequential. Under very benign scenarios, the serie C could receive principal payments before the serie B. These payments would correspond to released reserve fund moneys due to reductions in the required reserve fund level.

5.2. Priority of payments

Standard priority of payments

A combined priority of payments protects against payment interruption. Principal collections from assets can be used to pay timely interest on the serie A and serie B notes. Only a few days' worth of collections suffices to pay senior class interest and other more senior items, even in the unlikely event of servicer disruption. The priority of payments also allows credit enhancement to cover losses from negative carry or interest rate mismatches (see Figure 9).

Our analysis takes account of the demotion trigger on serie B interest. The rating of the serie B captures losses from the time value of missed interest payments resulting from a subordination of serie B interest payments to serie A principal. Missed interest payments do not accrue interest penalties for any of the classes.

Figure 9. Available funds and priority of payments

Pre-enforcement priority of payments	Post-enforcement priority of payments
Available funds Collections from assets, excluding retained principal to cover decreases of credit line usage and amortisation of the liquidity facility; proceeds from interest and treasury accounts and reserve fund.	**Available funds** All SPV moneys, including funds from asset liquidation.
1) Taxes and expenses (ordinary and extraordinary, including servicer fee if Santander were replaced) 2) Serie A interest pari-passu with liquidity facility interest (pro-rata) 3) Serie B interest, if not demoted 4) Principal for serie A, and then serie B a) Serie B interest, if demoted when b) Serie A still outstanding after payment date 5) Total defaulted assets > 5% of portfolio balance at closing 6) Reserve fund to its required level 7) Serie C interest 8) Principal for serie C (i.e. equivalent to reduction of required reserve fund amount) 9) Subordinated loan interest 10) Principal for subordinate loan 11) Servicer fee for Santander 12) Excess spread for originator as variable serie C interest	1) Taxes and expenses (ordinary and extraordinary, including servicer fee if Santander were replaced) 2) Serie A interest pari-passu with liquidity facility interest (pro-rata) 3) Principal for serie A pari-passu with liquidity facility balance 4) Serie B interest 5) Principal for serie B 6) Serie C scheduled interest 7) Principal for serie C 8) Subordinated items including servicer fee for Santander and excess spread for the originator

5.3. Reserve fund

Standard reserve fund mechanism of most Spanish securitisations

The structure features a fully funded cash reserve of EUR 110m, or 5% of the initial portfolio balance, which is the primary source of credit enhancement for the serie B. If the reserve falls below its target, excess spread would be captured for refinancing.

The reserve fund, combined with the provisioning mechanism, traps excess spread and enables the structure to sequentially accelerate serie A and B amortisation whenever assets are classified as defaulted..

The reserve fund is a source of negative carry because its cash account yields three-month Euribor, whereas the notes' weighted average coupon is always higher than this index (except when the three-month Euribor has a high negative rate, resulting in both yields having a floor at 0%). Negative carry directly impacts the serie C notes.

The reserve fund follows the standard mechanism of most Spanish securitisations. The required balance can reduce until it equals the lower of i) 10% of the cumulative outstanding amount of the serie A and B; and ii) 2.5% of the cumulative initial amount of the serie A and B (EUR 55.0m).

Amortisation is subject to:

i) non-defaulted assets more than 90 days past due being less than 2.5% of total non-defaulted assets;

ii) more than two years having elapsed since closing; and

iii) the reserve fund being fully funded at its required level on the previous payment date.

5.4. Liquidity facility

Increased credit line balances under stress can be serviced using principal collections from performing assets

The structure features a liquidity facility which is available to fund credit line draw-downs after closing. This facility is set at 5% of the serie A balance, and the issuer will be liquidated if it falls below this threshold. The liquidity facility is cancelled once all credit

lines have amortised.

Our cash flow analysis considers the use of the liquidity facility. However, this is unlikely given that any credit line draw-downs would likely be serviced using principal collections from performing assets. This assumption is based on the already very high drawn amount of the credit lines (97%) and on the portfolio's fast expected amortisation, particularly for this product type.

If drawn, the liquidity facility would become pro rata with serie A interest, and its balance would be offset against principal collections in the issuer's treasury account. The liquidity facility is linked to the treasury account, which is effectively a credit account that yields three-month Euribor on positive balances and charges a fee on negative balances (i.e. overdrafts) of three-month Euribor plus 25bps. There is no interest or fee on the committed and undrawn amount.

5.5. Subordinated loan to fund initial expenses

The issuer's initial expenses are covered by proceeds from a dedicated subordinated loan, which will be amortised using excess spread in the early stages of the transaction. The subordinated loan, granted by Santander to the issuer, carries an interest rate of three-month Euribor plus 65bps (with a 0% floor).

5.6. Interest and reset date mismatches

The transaction is exposed to interest risk because: i) no hedging agreement is in place; and ii) 27.6% of the assets pay a fixed interest rate, whereas 100% of the issuer's liabilities are referenced to three-month Euribor.

The transaction is also exposed to mismatches of reset dates and reset frequencies, resulting in rate risk for the noteholders.

Interest type and payment frequency generally accommodate the liabilities

The risk of unhedged interest rates is limited by the current low interest rate environment. In addition, the indices of floating-rate assets correlate strongly with that of the notes' (three-month Euribor). Potential losses from negative carry are factored into the ratings and are thus covered by available credit enhancement. The latter enables principal collections to be used for interest payments on the most senior classes.

5.7. Clean -up call

Our analysis did not incorporate the option to terminate the transaction before final legal maturity if the asset balance falls below 10% of the original portfolio's balance, as allowed by transaction conditions. This is because this option is discretionary and would require the notes' full repayment. The originator and the seller have the right to exercise this option.

5.8. Accounts

The issuer has two accounts for as long as credit lines exist in the portfolio.

Accounts represent commingling exposure to Santander, the account bank

The first, the treasury account, holds and retains principal collections from the assets for as long as the credit line balance exceeds the closing balance. The account uses daily principal collections to service increases in average credit line balances. This account is linked to the liquidity facility, which can be used if principal collections are insufficient to cover the increased credit line balances.

Once the credit lines fully amortise and the liquidity facility is repaid, the treasury account will be closed. At this point, its balance and respective assets and liabilities will be transferred to the interest account, the issuer's second account. This account holds the reserve fund and interest collections from the assets.

Both accounts represent commingling exposure to Santander as account bank, as well as a source of negative carry as their yields are lower than the notes' weighted average

coupon. Negative carry losses are covered by available excess spread and credit enhancement.

6. Quantitative analysis

We used a bespoke cash flow to analyse this transaction

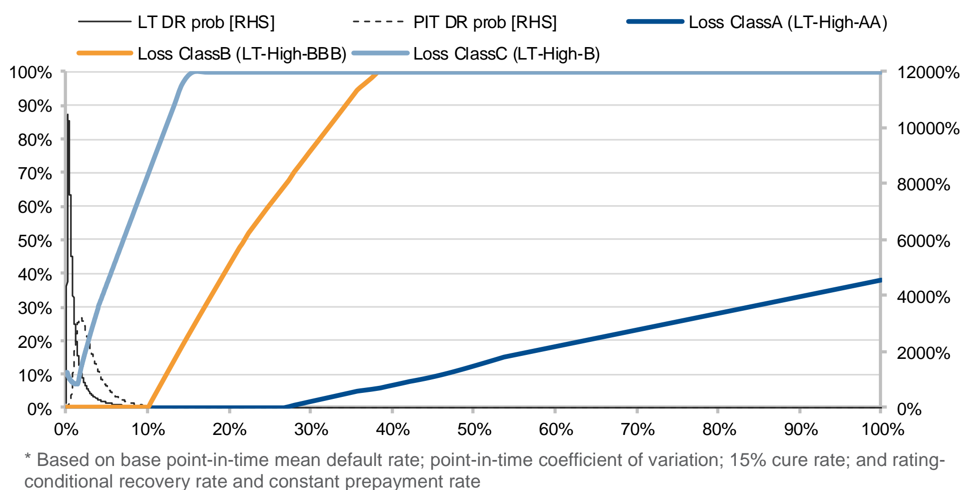
Our analysis of the transaction's cash flows incorporates key mechanisms in the structure. We applied a large homogenous portfolio approximation approach to analyse the highly granular collateral pool and to forecast cash flows over the amortisation period. The cash flow analysis considers the probability distribution of portfolio default rates, following an inverse Gaussian distribution, to calculate the expected loss of each rated tranche. The analysis also provides the expected weighted average life of each tranche. We have considered asset and liability amortisation and the expected evolution of the pool composition.

Our assumptions for PYMES 14 were derived from a portfolio dated 15 October 2018.

We assigned a AA+$_{SF}$ rating to the serie A based on our cash flow analysis, which accounted for the distribution of long-term-adjusted portfolio default rates and the consideration of qualitative factors. This analysis is supported by positive macroeconomic conditions, the credit enhancement available to the serie A, and Santander's strict underwriting process.

Figure 10 shows the losses of each tranche for portfolio default rates from 0% to 100%. The chart shows the protective effect of credit enhancement, excess spread, and recovery after default. The latter two elements explain why serie A and B can withstand default rate scenarios beyond their initial respective credit enhancement levels of 16.8% and 5.0%

Figure 10. Quantitative results



* Based on base point-in-time mean default rate; point-in-time coefficient of variation; 15% cure rate; and rating-conditional recovery rate and constant prepayment rate

7. Rating stability

7.1. Rating sensitivity

The strong protection mechanisms of the structure support rating stability

We have tested the resilience of the assigned ratings against deviations of the main input parameters: the portfolio mean default rate and recovery rates. This analysis has the sole purpose of illustrating the sensitivity of the rating to input assumptions and is not indicative of expected or likely scenarios.

Figure 11. Sensitivity to the portfolio default rate

Default rate sensitivity: notches from the assigned ratings	Serie A	Serie B	Serie C

Base case default rate: +50%	-2	-2	-1

Figure 12. Sensitivity to the portfolio recovery rate

Recovery rate sensitivity: notches from the assigned ratings	Serie A	Serie B	Serie C
Base case recovery rate: -50%	-1	- 1	-1

7.2. Break-even analysis

Serie A would not experience any loss under portfolio default rates of 26.5% or lower

The resilience of the serie A rating is illustrated in the break-even default rate analysis. The serie A would not experience any loss at portfolio default rates of 26.5% or lower under a 15% prepayment rate assumption and a 24.6% recovery rate assumption.

The serie B would not experience any loss at portfolio default rates of 9.9% or lower under a 15% prepayment rate assumption and a 40.2% recovery rate assumption.

The serie C experiences losses under every default rate scenario.

8. Sovereign risk

Sovereign risk does not limit the transaction's ratings

Sovereign risk does not limit the ratings. The risks of disorderly sovereign default, an institutional framework meltdown, legal disruption or currency convertibility problems due to Spain's hypothetical exit from the eurozone are not material for the notes' rating.

For a detailed insight into our fundamental analysis of the Spanish economy, please refer to our rating report on the Kingdom of Spain, dated 30 June 2018.

8.1. Spanish economic environment

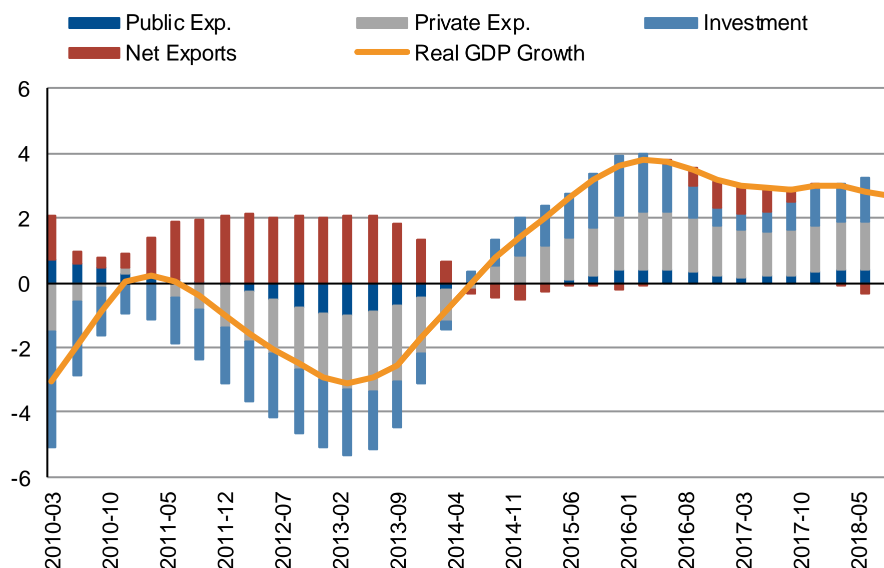
Following two consecutive shocks, namely the Great Financial Crisis and the euro area crisis, during which Spain requested financial assistance to recapitalise financial institutions in July 2012, the Spanish economy has undergone a significant structural adjustment. Since Spain exited the European Stability Mechanism programme in January 2014, its economy has grown, on average, around 2.6%, well above the euro area average, which has grown at 1.9%. This has been driven by the government's structural reforms, which were mostly implemented from 2010-15, wage moderation and resulting cost-competitiveness gains, low oil prices, the ECB's accommodative monetary policy, and favourable external conditions, particularly in the euro area. We expect this benign combination of factors to continue, albeit to a lesser degree, sustaining Spain's balanced and employment-intensive economic expansion over the next few years, albeit with less dynamism, moderating economic growth to 2% over the medium term.

The structural adjustment has resulted in a shift in resources towards the dynamic, export-oriented services sector, which has replaced the outsized construction sector as the engine of growth and job creation. In addition, wage moderation, as evidenced by real unit-labour costs falling by 7.6% since 2009 (based on AMECO data), compared to a broadly stable development in the euro area, have led to gains in cost competitiveness and resulted in significant job creation. More than half of the 3.8m jobs lost during the crisis have now been recovered2. We also note that banking sector reforms have contributed to tougher bank lending standards, steering the allocation of credit towards more productive and financially sounder firms, supporting the investment recovery.

Looking ahead, we expect continued household deleveraging, in light of low overall net wealth and savings rates, to dampen consumption somewhat, while investment growth is expected to remain robust over the medium term, even if financial conditions were to tighten slightly following the eventual normalisation of the ECB's monetary policy. Fiscal policy support will also likely remain mildly positive, particularly in view of some of the expansionary measures of the 2018 budget. Finally, taking into account the lower trade

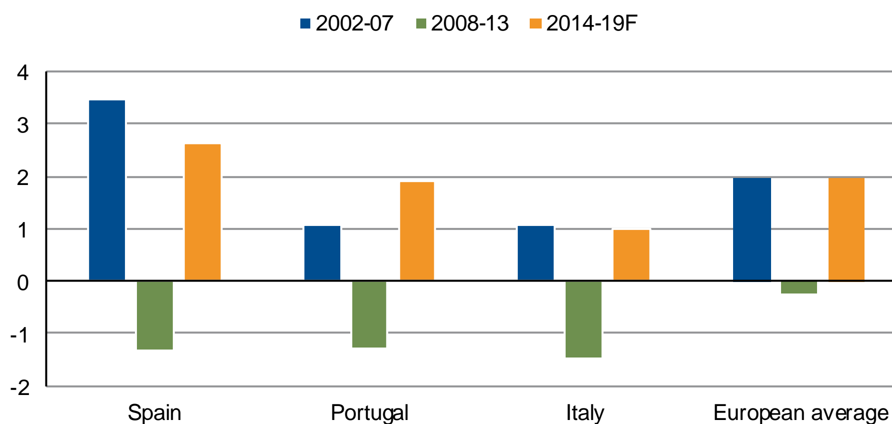
balance, the current account is projected to stabilise at around 1.4% in the medium term, driven by weaker foreign demand, as well as a slowdown in tourism.

Figure 13. Real GDP growth, %



Source: Haver, INE, Scope Ratings

Figure 14. Average real GDP

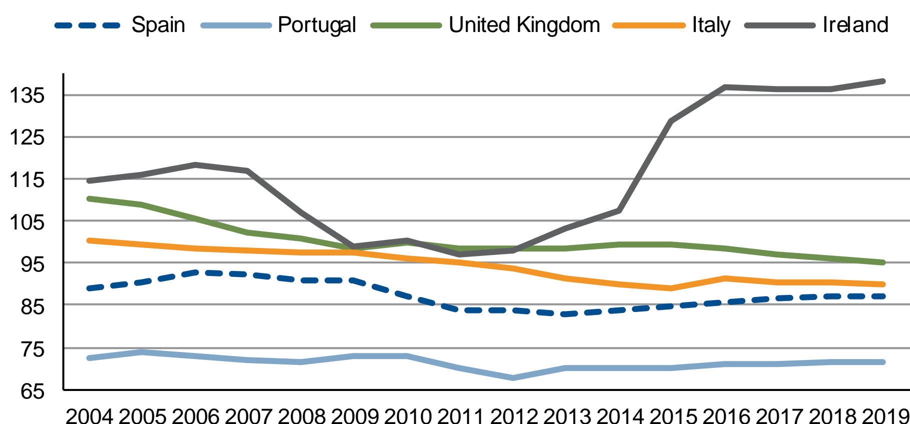


Source: Haver, European Commission, Scope Ratings

While the short-to-medium-term growth outlook is robust, Spain's long-term economic growth prospects face considerable challenges. The IMF estimates potential growth at around 1.7%, slightly above the European Commission's estimate of 1.5% over the medium term, constrained by weak productivity growth, unfavourable labour force demographics, and high structural unemployment. According to the IMF, productivity levels in Spanish manufacturing, trade and market services sectors are considerably lower than those of EU peers due to Spain's corporate structure, which is composed of low-productivity small and micro-firms. The IMF further points to the need to fully implement the Market Unity Law, liberalise professional services, enhance access to equity-financing for start-ups, reduce size-related requirements, and improve public R&D spending to raise potential growth and competitiveness. These constraints are reflected in the fact that, based on OECD data, about half of real GDP growth over 2014-16 was driven by total hours worked, whereas the contributions from capital and total-factor productivity were approximately equal. While this is slightly better compared to peers

such as Portugal or Italy, it points to a need for Spain to improve its productivity levels, which are the main growth driver among higher-rated peers. In this context, we note positively that the economy's improved fundamentals, including a turnaround in productivity growth from its pre-crisis negative trend, suggest longer-term payoffs from past structural reforms.

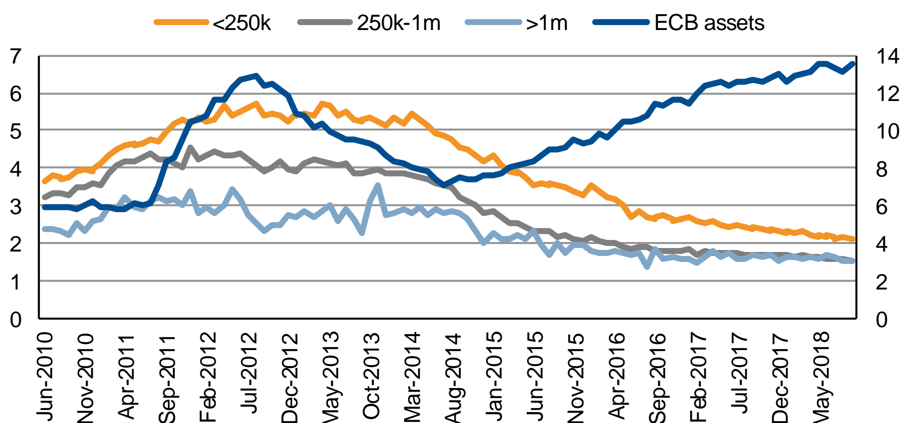
Figure 15. GDP potential growth, %



Source: Haver, AMECO, Scope Ratings

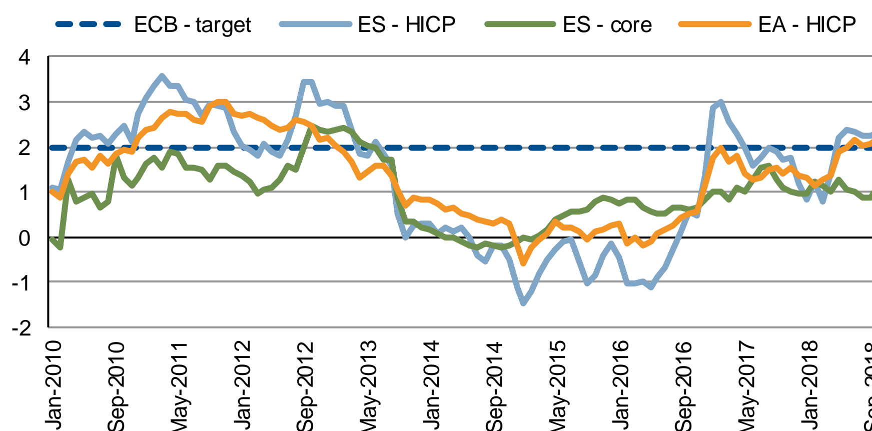
In our opinion, the national structural reforms, combined with the euro area governance reforms and the ECB's actions, have led to a significant decline in financing rates for all sectors of the economy including non-financial corporations, whose borrowing rates have dropped between 200bps and 300bps depending on loan size and maturity. At the same time, we note that in the case of Spain, the sustained accommodative monetary policy stance is also adequate in light of still-subdued price levels. While headline inflation has been above 2% since May this year, the price level is expected to gradually moderate to around 1.5% in 2020, driven by base effects in oil prices. This is in line with euro area core inflation but still markedly below the ECB's target of close to but below 2%.

Figure 16. Non-financial corporations: borrowing rates (%)



Source: Haver, Bank of Spain, ECB, Scope Ratings

Figure 17. Harmonised index of consumer prices, % and ECB assets (% of GDP, RHS)



Source: Haver, Bank of Spain, ECB, Scope Ratings

9. Counterparty risk

The transaction is exposed to counterparty risk with Santander given its wide-ranging roles as servicer, account bank, paying agent, liquidity facility provider and subordinated loan provider. This risk is mitigated by our stable forward-looking credit view on Santander (AA-/S-1/Stable), the serie A's short expected life, and counterparty protection features including the bank's automatic replacement (as servicer, account bank and paying agent) upon a rating downgrade below a BBB. The bank's systemic importance and resolvability also supports our view.

9.1. Operational risk from servicer

We consider Santander's replacement as portfolio servicer to be highly unlikely and believe that a servicer replacement would be more disruptive than Santander continuing as a going concern through a hypothetical resolution process. This view is supported by Santander's relevance to the Spanish economy and the framework for orderly bank restructuring in Europe.

9.2. Commingling risk from account bank

Commingling risk is sufficiently remote and hence immaterial for serie A

In addition to the protection mechanism and mitigants highlighted above, comingling risk from the exposure to the servicer is immaterial because collections from assets are transferred to the issuer's account generally intraday, but no later than 48 hours.

9.3. Set-off risk from originator

Set-off risk from the originator is limited in the context of Spanish law and under the terms of the documentation. The structure incorporates an undertaking by the seller to compensate the issuer for any set-off loss resulting from rights existing prior to the asset transfer. Furthermore, set-off rights would cease to exist after obligor notification following a servicer event, or upon the insolvency of either the obligor or seller.

We believe set-off risk from the originator is immaterial

For mortgages, exposure to set-off risk from linked contracts is negligible and restricted to insurance contracts. This exposure is largely to Santander's insurance business, limited to premia paid upfront and capitalised in the mortgage balance. This is a negligible amount, which is also covered by credit enhancement.

10. Legal structure

10.1. Legal framework

The transaction conforms to Spanish securitisation standards effective since 28 April 2015

This securitisation is governed by Spanish law and represents the true sale of the assets to a bankruptcy-remote vehicle without legal personality, represented by Santander de Titulización SGFT SA, the management company. The issuer is governed by the terms in the documentation. Changes to the documentation require the unanimous agreement of all stakeholders to the transaction, i.e. noteholders and creditors.

This securitisation has been incorporated as a 'Fondo de Titulizacion' (FT, securitisation fund). The FT legal form was introduced in 28 April 2015 via Law 5/2015 to promote corporate financing. This law reformed the Spanish securitisation framework and replaced 'Fondo de Titulizacion de Activos' (FTA, asset securitisation funds) and 'Fondos de Titulizacion Hipotecaria' (FTH, mortgage securitisation funds).

10.2. Asset replacement

Santander pledges that it will replace or repurchase any asset transferred to the portfolio that does not comply with eligibility criteria in the documentation. Assets more than 30 days in arrears at the time of transaction closing cannot be transferred to the portfolio. We believe the risk of weaker assets transferred to the final portfolio is covered by our mean default rate assumption for the portfolio.

10.3. Permitted variations

The documentation allows for obligor-initiated modifications to the terms of contracts in the portfolio, notably for interest rate and maturity. In all cases, negotiations with obligors would follow the originator's standard procedures and approval processes.

The documentation includes covenants to prevent the economic imbalance of the transaction as a result of permitted variations. These covenants limit any material migration of the portfolio beyond that related to asset performance.

10.4. Use of legal opinions

We have reviewed the legal opinion for the issuer and have confidence in the oversight of Spanish regulator, CNMV, which provides comfort on the issuer's legal structure. The transaction conforms to Spanish securitisation standards, effective since 28 April 2015, and is consistent with our general legal analytical assumptions.

10.5. Agreed-upon procedures report (AUP)

A reputable audit company undertook an independent due diligence analysis on the portfolio based on the same data-points as PYMES 13. Such a process is generally undertaken at borrower and loan levels, as well as i) at collateral level for the mortgages; and ii) on the undrawn balance for the credit lines. The collateral valuation date was not assessed, but this is partially mitigated with the 30% haircut we applied to the property valuations. We verified the sample that represents the population, based on a certain level of confidence (i.e. 95% or 99% according to the data-points tested). No material errors were reported within such confidence levels.

11. Monitoring

We will monitor this transaction on the basis of performance reports from the management company as well as other available information. The ratings will be monitored continuously and reviewed at least once a year, or earlier if warranted by events.

Our analysts are available to discuss all the details surrounding the rating analysis, the risks to which this transaction is exposed and the ongoing monitoring of the transaction.

12. Applied methodology and data adequacy

For the analysis of this transaction we have applied our SME ABS Rating Methodology, dated August 2018, and Methodology for Counterparty Risk in Structured Finance, dated August 2018, all available on our website, www.scoperatings.com.

Santander de Titulización SGFT SA provided us with default and recovery data, segmented by quarterly vintage of origination, referring to a ‘90 days past due’ default definition. The default rate loan data covers 2012 onward and is very granular. The loan recovery data also covers 2012 onward, referring to all recoveries during that period. The credit line default rate and recovery data covers a period of 2011 and onward. Santander noted that the data represents the performance of SME loan exposures and has similar characteristics to the selected transaction portfolio.

I. Appendix: Summary of portfolio characteristics

Key features	PYMES 14	PYMES 13	PYMES 12	PYMES 11	PYMES 10
Originator	Santander, Banesto and BANIF	Santander, Banesto and BANIF	Santander, Banesto and BANIF	Santander and Banesto	Santander and Banesto
Closing date	26 Nov 18	25 Jan 18	14 Dec 15	22 May 15	04 Dec 14
Portfolio balance (EUR m)	**2,518**	3,062	2,800	3,681	4,215
Number of assets	**40,827**	61,893	39,559	59,592	50,411
Number of obligors	**36,148**	60,219	36,551	54,662	45,303
Average asset size (EUR m)	**61,681**	49,476	70,780	61,764	89,188
Maximum asset size (EUR m)	**14,973**	25,000	21,204	27,000	28,394
Small and medium-sized enterprises	**87.4%**	89.26%	81.20%	98.10%	86.60%
Self-employed	**12.60%**	10.74%	18.80%	1.90%	13.40%
Largest obligor	**0.64%**	0.82%	0.80%	0.70%	0.70%
Top 10 obligors	**4.8%**	7.31%	5.10%	6.50%	5.60%
Top 20 obligors	**8.3%**	10.01%	8.40%	10.80%	9.00%
Largest region	**16.7%**	20.96%	20.00%	21.30%	23.60%
*Top 3 regions**	46.0%	43.37%	48.40%	51.50%	53.50%
Largest sector	**25.8%**	21.80%	19.60%	18.70%	15.70%
	Wholesale and retail trade	Wholesale and retail trade	Mining and metals	Wholesale and retail trade	Real estate and construction
Top 3 sectors	**56.4%**	42.27%	40.90%	43.90%	38.50%
Weighted average life (0% default rate and 0% constant prepayment rate) (years)	**1.6**	1.5	2.8	1.9	2.8
Weighted average one-year probability of default (Santander figures)	**0.94%**	2.06%	3.30%	5.60%	3.20%
Current weighted average coupon	**2.16%**	2.45%	2.60%	3.40%	3.80%
Fixed-rate assets (% of balance)	**27.6%**	20.76%	25.00%	21.80%	19.40%
Weighted average coupon of fixed-rate assets	**2.87%**	2.97%	3.30%	4.80%	5.20%
Weighted average margin of floating-rate assets	**1.90%**	2.10%	2.00%	2.70%	2.80%
Amortising loans	**98.45%**	80.54%	87.40%	53.20%	71.80%
Bullet loans	**1.55%**	19.44%	12.60%	46.80%	28.20%
Credit lines	**29.9%**	19.44%	17.40%	39.50%	17.80%
of which, reconducted	**0.00%**	0.00%	1.80%	0.00%	4.50%
Weighted average one-year probability of default (Santander figures)	**1.13%**	3.13%	2.10%	2.20%	3.50%
Secured loans	**6.6%**	23.25%	15.00%	9.30%	22.30%
of which, reconducted	**0.00%**	0.00%	42.00%	18.30%	19.70%
for which, weighted average loan-to-value	**67.0%**	50.80%	101.30%	72.90%	64.40%
Weighted average one-year probability of default (Santander figures)	**0.97%**	1.98%	9.50%	18.50%	3.00%
Unsecured loans	**63.5%**	57.32%	67.60%	51.20%	59.80%
of which, reconducted	**0.00%**	0.00%	3.40%	7.40%	5.60%
Weighted average one-year probability of default (Santander figures)	**0.85%**	1.73%	2.20%	5.90%	3.20%
Debt consolidation (reconducted or refinancing)	**0.00%**	0.00%	9.20%	5.50%	8.70%

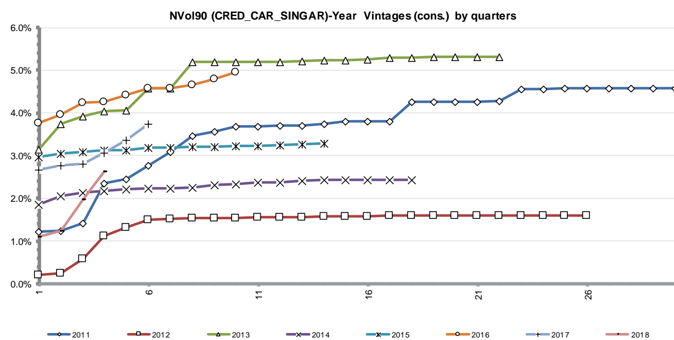
II. Appendix: Mortgage exposures and collateral geographic distribution (table)

Region	Exposure	Collateral	Weighted average LTV	LTV >80%
Madrid	44,097,869	66,589,938	68.3%	13.0%
Catalonia	24,930,946	37,976,302	70.1%	31.9%
Andalusia	19,000,912	30,867,573	66.3%	40.6%
Canary Islands	18,845,988	29,557,484	66.6%	10.2%
Asturias	8,556,028	13,175,232	66.5%	0.0%
Valencia	8,304,886	12,922,577	68.3%	27.4%
Castilla-La Mancha	8,299,312	12,665,415	66.6%	5.0%
Castilla and León	8,117,992	11,824,119	69.8%	11.7%
Basque Country	6,037,617	11,073,355	59.5%	0.0%
Extremadura	3,863,263	5,774,544	71.0%	66.7%
Aragon	3,601,423	6,489,763	57.8%	0.0%
Murcia	3,528,743	5,800,899	61.3%	2.8%
Balearic Islands	3,303,880	5,775,861	58.1%	0.0%
Galicia	1,875,285	3,141,817	63.3%	30.5%
La Rioja	1,067,679	1,962,319	54.5%	0.0%
Cantabria	988,398	1,729,607	61.1%	17.3%
Navarre	462,582	719,830	64.6%	0.0%
Ceuta	250,078	387,497	64.5%	0.0%
Melilla	129,370	267,546	48.4%	0.0%

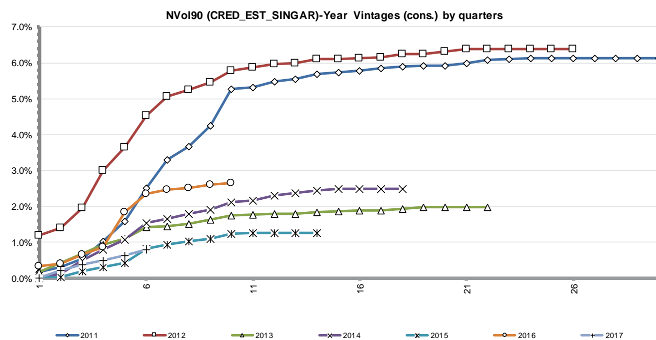
III. Appendix: Vintage data provided by Santander

90 days past due delinquency data

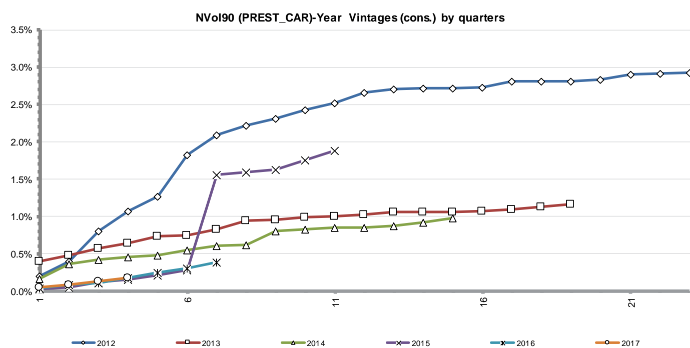
Credit lines to large obligors



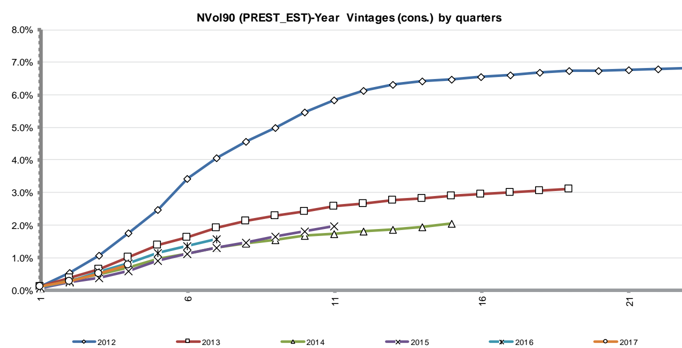
Credit lines to small obligors



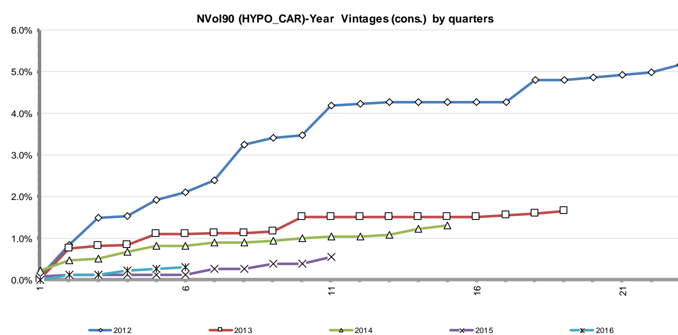
Unsecured loans to large obligors



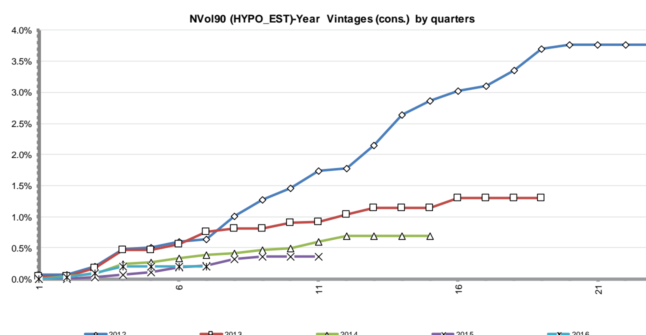
Unsecured loans to small obligors



Secured loans to large obligors

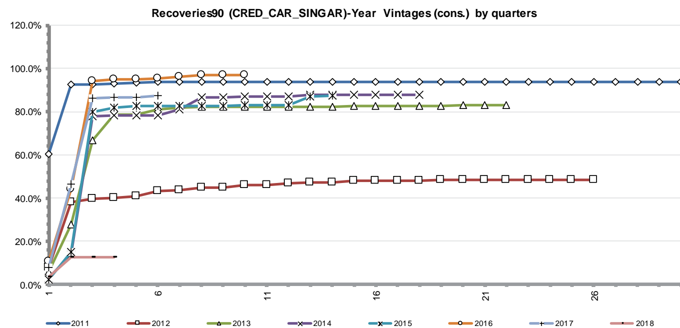


Secured loans to small obligors

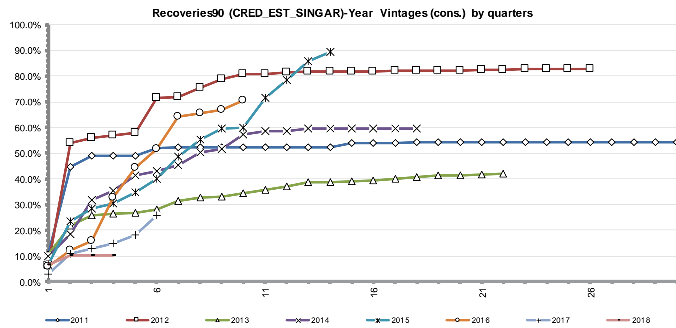


90 days past due recovery data

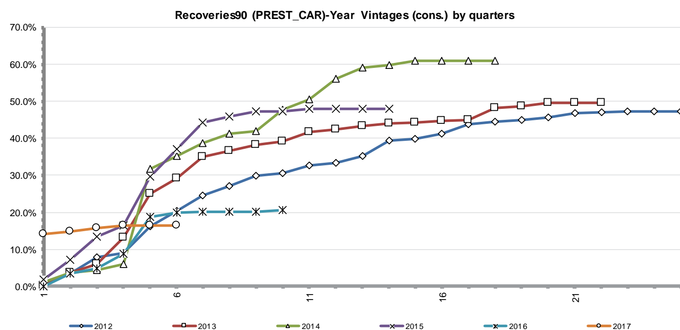
Credit lines to large obligors



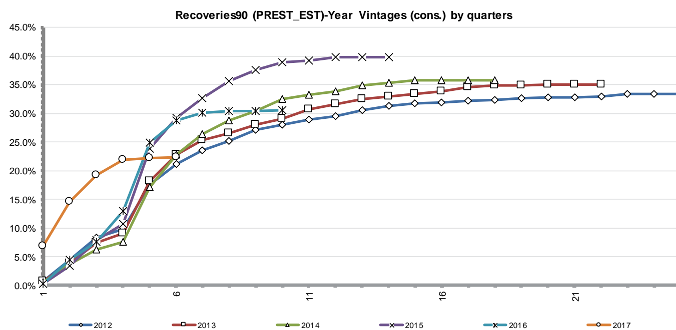
Credit lines to small obligors



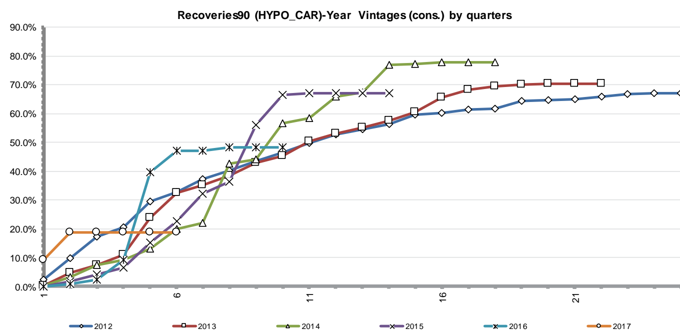
Unsecured loans to large obligors



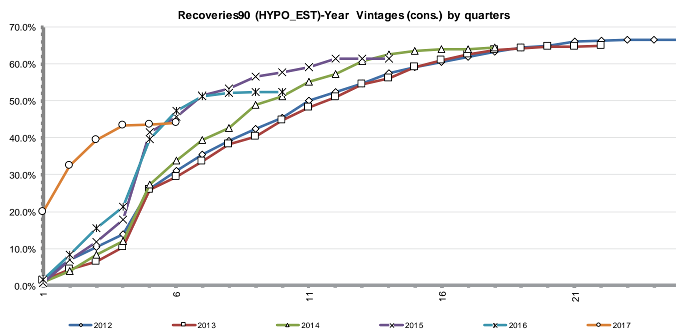
Unsecured loans to small obligors



Secured loans to large obligors



Secured loans to small obligors



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